

**Agenda Item:** 8-5  
**Meeting Dates:** April 7 and 8, 2004

## INFORMATIONAL REPORT ON THE FINANCE OPTIONS REPORT

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**Summary:** This report provides an overview of the principles, issues and options from the CALFED Program Finance Options Report.

**Recommended Action:** This is an informational item only. No action will be taken.

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### **Background**

Authority staff is preparing a Finance Options Report. The primary purpose of the report is to provide interested parties with a set of reasonable and instructive finance options for implementing the long-term CALFED Program.

The Authority is facing the sizeable challenge of implementing a very large and interrelated Program to meet the CALFED Program objectives in the face of an unprecedented State fiscal crisis and a severe Federal fiscal shortfall. As a result, State and Federal policy makers are facing some particularly tough choices with regard to how to spend scarce public funds. The recent history of public funds being made available on a large scale for Program implementation is not likely to continue in the near-term future. In addition, many of the current implementation activities will be out of existing bond funds by the end of 2006 or 2007. In order to insure the CALFED Program implementation is not jeopardized, the beneficiaries (e.g., State, Federal, water user, local) of the planned Program actions must find ways to collectively supplement and leverage the dwindling public funds to realize the benefits envisioned in the Record of Decision (ROD). This report attempts to provide relevant information to make the tough choices a little easier where possible.

At the October 2003 Authority meeting, Authority staff provided an overview of an initial report entitled, "The Framework and Issues Report." At the December 2003 and February 2004 Authority meetings, the Finance Report agenda item was deferred. In the December packet and distributed at the December meeting were Authority staff comments and summaries of the first meeting of the Finance Independent Review Panel convened by the Director, the Panel bios, and a list of Finance participants. All materials can be found on the Authority web page at:  
<http://calwater.ca.gov/FinancePlanning/FinancePlanning.shtml>

**Independent Review Panel Report.** In December, the Authority received the summary of the Panel's first meeting, the Panel comments and recommendations to the Authority, and the Authority staff response to the Panel comments. Generally, the Panel supported the approach the Authority was taking, but they also made recommendations in four areas:

1. Provide greater context for developing finance options
2. Develop alternative approaches to funding/financing
3. Produce a first-order test of benefits
4. Consider evaluating multiple baselines

The Authority staff provided a written response to the Panel and met with the Panel by teleconference in December. As a result of this further discussion with the Panel, the Authority staff and Panel are in agreement on the framework for proceeding with the Finance Report.

**Current Status.** The Finance Options Report is being drafted by the Authority staff and a Technical Team of consultants. Working drafts are being reviewed by the Ad Hoc Work Group (17-member stakeholder and agency group) and the Independent Review Panel (8 members). The report will consist of several sections including an historical background on water financing, current trends in water and environmental financing in other states, a summary of the current fiscal conditions in the State and the Federal governments, guiding principles for developing finance options, and finance options for allocating the cost of the CALFED Program. The finance options will be based on the best available information regarding the benefits and costs for each program element.

The Authority staff and Technical Team are drafting sections of the Finance Options Report as working drafts to be reviewed by the Ad Hoc Work Group and the Independent Review Panel on a flow basis between January and March 2004. In mid-April a draft Options Report is scheduled to be completed. In late April an Independent Review Panel public meeting is scheduled. A final Finance Options Report is scheduled to be completed in May or June of 2004. An update on the Options Report will be provided to the Authority at the June 2004 meeting.

**Guiding Principles for Developing Finance Options.** Many issues and considerations arise in the development of the Finance Options Report for the CALFED Bay-Delta Program. To promote consistency and transparency of assumptions, the Technical Team identified guiding principles to direct the development of Finance Options. (These are in additions to, and in some cases clarifications of, the principles listed in the CALFED Program [BDP] Framework and Issues Report, October 2003). (See Attachment 1)

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**April California Bay-Delta Authority Meeting.** At this meeting, Authority staff, the chair of the Independent Review Panel (Professor David Dowall; U.C. Berkeley), and a Technical Team representative (David Mitchell, M.Cubed private consultant) will provide:

- A brief summary of the process, schedule and participants for development of the Finance Options Report.
- An overview of the Guiding Principles being used by the Technical Team to develop finance options.
- Examples of the finance options being developed for several of the CALFED Program elements.

**Fiscal Information**

Not applicable

**Attachment**

Attachment 1 – Summary of Guiding Principles for Developing Finance Options

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## Attachment 1

### California Bay-Delta Authority Summary of Guiding Principles for Developing Finance Options

1. Program/Project Selection. A necessary step in developing a Finance Options Report was to specifically describe the programs or projects that would be evaluated in this report. For this report, the Technical Team described and analyzed the programs and projects identified by the CALFED Program managers.

The Technical Team did not attempt to select or optimize the choices or configurations of the programs or projects that are expected to comprise the CALFED Program. When information about programs and/or projects was highly uncertain (i.e., there exists no agreement as to whether, when, or in what form the programs or projects would proceed), the Technical Team described the programs or projects in the report but did not develop finance options for them

2. Cost Estimates. Estimates of program costs were developed for the period 2000 through 2030, as data permitted. A range of costs was developed for most programs and projects to reflect: (1) uncertainty in the actual amount of expenditure that may be required to achieve a ROD target, (2) uncertainty about the cost to construct or operate a project, and (3) uncertainty about the cost to administer a program or project.

After developing an initial estimate of costs, the Technical Team reduced the cost estimate to account for any previously dedicated funds (either appropriated funds or bond revenues) that have not been spent. This adjustment allows the report to analyze the balance of the costs that would need to be financed.

3. Cost Allocation. A benefits-based finance report requires a method of identifying what benefits are being generated by a project/program and then assigning the costs among the beneficiaries – a process called cost allocation. Benefits are defined broadly here to include mitigation responsibility if appropriate. The Technical Team assigned costs to beneficiaries based on the following guiding principles:
  - *Specific and separable costs*: Program costs that could be readily identified with producing a specific product or producing a specific service were allocated to the beneficiary group or groups directly benefiting from this product or service.
  - *Joint costs*: Most of the costs the Technical Team analyzed were joint costs. The principal challenge with joint costs is how best to divide them among the multiple products or services they produce. Wherever possible, the Technical Team used a quantitative approach to allocate joint costs. The Team followed one of the following allocation methods when addressing joint costs:

*Economic benefits* - The method assigns costs to different beneficiary groups in proportion to the economic benefits they are expected to receive.

*Physical changes* - Allocate joint costs in proportion to the share of physical changes received. For example, if the only benefit were a change in water supply reliability, then joint costs could be allocated based on the expected changes in water supply shares to different water users.

*Status Quo* - If there was a long history of funding for certain programs or types of projects, a status quo allocation, reflecting historical funding shares for Federal, State, and other program or project participants was used as an example allocation.

*ROD* - If there was an allocation proposed in the ROD and economic or physical changes could not be measured, then one of the allocation examples could include the ROD allocation.

*Instructive* - In some cases where stakeholders disagree strongly about the outcome of the potential investment, in particular with regard to baseline issues, one or more cost allocations were presented that emphasize one or more of the divergent views.

#### 4. Finance Options.

- *Debt Financing:* In developing finance options for projects or programs with significant expenditures for capital assets the Technical Team attempted to include at least one finance option that used medium to long-term debt obligations
- *Pay-As-You-Go Financing:* Pay-as-you-go financing refers to the financing method whereby programs or projects are wholly or partially financed from current revenues generated by taxes, fees, service charges, special funds, and/or special assessments. In developing CALFED Program finance options, the Technical Team assumed pay-as-you-go financing could be used in the following circumstances:
  - *Annual operating, maintenance, and administrative costs:* Costs would be paid from current revenues, such as General Fund appropriations, fees, and user charges.
  - *Capital costs assigned to U.S. taxpayers:* Capital costs assigned to U.S. taxpayers would be financed using pay-as-you-go through the Federal appropriations process.

- *Capital costs assigned to California taxpayer:* For some CALFED Program elements, the Technical Team developed one finance option where capital costs assigned to California taxpayers were financed using pay-as-you-go and one where these costs were financed with GO bonds. The purpose of the two examples was to highlight the differing impacts to the State's General Fund.